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AUTHOR Spellman, Robert L.
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ABSTRACT

Although noting that the Securities and Exchange Commission (SEC) has been a valuable ally of journalists, this paper suggests that recent efforts of the SEC in prosecuting the case of R. Foster Winans, Jr., a former writer for the "Wall Street Journal," may be unconstitutional. Following an introduction to the First Amendment issues raised, the paper provides background information about Winans's case, in which he was charged with securities fraud for leaking financial information to his confederates prior to publication in his column. The paper next explains the misappropriation theory, which led to a charge of misappropriation against Winans, and discusses the belief of the SEC that journalists have an obligation under federal securities laws to disclose to readers if they are trading in the securities about which they are writing. Finally, the paper acknowledges that the SEC's actions are not the first efforts by government to apply sanctions against news outlets for what is printed or broadcast, but states that the agency's legal basis is unique. Furthermore, this last section of the paper asserts that the Supreme Court must decide whether the First Amendment bars the imposition of security law liability upon the editorial process. (DF)

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FINANCIAL JOURNALISM UNDER FIRE:

THE SEC AND NEWSROOM ETHICS*

By Robert L. Spellman**

*This paper has been prepared for presentation to the Law Division, Association for Education in Journalism and Mass Communication, on Wednesday, August 6, 1986, in Norman, Oklahoma.

**The author is an attorney and assistant professor of journalism at Southern Illinois University at Carbondale.

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FINANCIAL JOURNALISM UNDER FIRE:

THE SEC AND NEWSROOM ETHICS

Since its creation the Securities and Exchange Commission (SEC)[1] has been a valuable ally of journalists. The theory underlying federal securities law is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor."[2] The system of disclosure required of publicly held corporations and well-heeled investors is financial journalism's most significant font of information on American business. So there is irony in the SEC's current intrusion into newsrooms and its so far successful effort to turn the ethics code of the Wall Street Journal into federal law. It underscores the warning of Justice Louis D. Brandeis.

> "Experience should teach us to be most on our guard to protect liberty when the Government's purposes are beneficient. Men born to freedom are naturally alert to repel invasion of their liberty by evil-minded rulers. The greatest dangers to liberty lurk in insidious encroachments by men of zeal, well-meaning but without understanding."[3]

The current SEC effort arises from the misconduct of R. Foster Winans, Jr., a former writer for the "Heard on the Street" column, a daily feature in the Wall Street Journal. After an SEC probe, Winans was prosecuted by the Justice Department. He was convicted by a federal district court of criminal securities fraud for accepting $31,000 to leak prior to publication the contents of "Heard on the Street" columns to confederates. He also was convicted of mail and wire fraud.[4] The confederates realized about $690,000 in profits from stock market trading

based on the leaks.[5] Winans was sentenced to serve 18 months in prison and pay a $5,000 fine.[6] The conviction was upheld by a 2-to-1 vote of the Second Circuit Court of Appeals.[7] Winans also was sued for civil securities fraud by the SEC. That suit was settled by a consent decree in which Winans admitted no liability but agreed to pay $4,584 and refrain from future violations of securities laws.[8] David R. Carpenter, a copyboy at the Wall Street Journal, was convicted on abetting Winans' scheme.[9]

Journalists are not exempt from securities laws,[10] but those laws may not be applied unconstitutionally.[11] Financial journalism is protected by the First Amendment. As one court said, "The public interest is served equally when reporters find a 'Deep Throat' in the executive suite."[12] In the Winans case, the government advanced two theories of securities law violations which, news organizations contend, infringe upon the First Amendment. News organizations opposed the imposition of civil or criminal liability based on the theories.[13] The news organizations did not oppose prosecution for Winans on mail and wire fraud because the charges did not include intrusion into the editorial process or publication as essential elements of liability.[14]

This paper will describe and analyze the legal background of the government's two theories and the dangers to the editorial process posed by them. The actions of the SEC by necessity force

an analysis of fine points of federal securities law and how they relate to the First Amendment.

BACKGROUND OF WINANS CASE

Winans was charged with civil and criminal liability under Section 10(b) of the Securities Exchange Act of 1934[14] and Rule 10b-5[16] promulated thereunder. The rule makes it illegal to engage in fraud or deceit "in connection with the purchase or sale of securities." In some instances fraud has included failure to disclose information before engaging in securities trading.[17] Both the criminal indictment and civil suit against Winans charged that he violated Section 10(b) and Rule 10b-5 under the following two theories.

(1) Winans misappropriated property of the Wall Street Journal by failing to disclose to his editors that he was leaking in advance information on "Heard on the Street" columns and that he profited from the leaks.[18] The stolen property was the "timing and tenor of market-sensitive stories scheduled to appear in the paper."[19] This theory was the basis of his criminal conviction.

(2) Winans committed fraud by violating "his duties owed to the readers of the Wall Street Journal, including a duty to disclose that Winans and his co-conspirators had traded in securities knowing that the Wall Street Journal would publish articles written by Winans or others concerning thcse securities"

and that he intended to profit by trading on the advance knowledge.[20] This theory was dropped by the Justice Department in the criminal prosecution, but it remained part of the SEC civil suit.

The charges involved the leaking of information on 27 "Heard on the Street" columns, not all of which Winans wrote, between early 1983 and early 1984. Most columns appeared after mid-October of 1983. The government did not claim that any information in the columns was false or confidential. None of the columns made buy or sell recommendations on securities. There was ample evidence "Heard on the Street" columns affected market volume and prices.

THE MISAPPROPRIATION THEORY

In more detail, the misappropriation charge said Winans:

> "...violated his fiduciary duties owed to the Wall Street Journal, including a duty of honesty, loyalty and silence, a duty not to use the news pages of the Wall Street Journal for his personal benefit, a duty to report to his superiors advance leaks of stories that he knew or believed to have caused trading in securities, a duty to refrain from trading based upon advance knowledge of Wall Street Journal articles, and a duty to report to his superiors any inadvertent trading for his benefit in securities that were to be the subject of a forthcoming article."[21]

Critical to the misappropriation theory as applied to Winans was the Wall Street Journal's ethics code. The code is found in a 44-page booklet on company policy and in a separate three and one-half page statement on conflicts of interest. The statement

"specifically forbids the purchase or sale of securities on the basis of articles an employee knows will appear in the newspaper; it also states that employees should not disclose the paper's future contents to anyone outside the company."[22] The statement also says that "all material gleaned by you in the course of your work for Dow Jones is deemed to be strictly the Company's property."[23]

The misappropriation theory stems from the 1980 decision of the Supreme Court in Chiarella v. United States.[24] Chiarella worked for a company which printed documents related to corporate takeovers. The company warned employees that information in the documents was confidential. Chiarella used information gained in his employment to buy shares of target companies before the takeover offers were made public. He realized profits of about $30,000 during a 14-month period. His activities were discovered and he was convicted of criminal violation of Section 10(b) and Rule 10b-5. Chiarella's conviction was based on the theory that he had a duty to disclose his knowledge of impending takeover bids to shareholders of target companies before buying their stock.

The Court overturned Chiarella's conviction,[25] but in doing so suggested that it might have been upheld if the trial court had properly charged the jury on a theory of securities fraud through misappropriation. As Chief Justice Burger said:

"(T)he evidence shows beyond all doubt that Chiarella, working literally in the shadows of the warning signs in the printshop, misappropriated---stole to put it bluntly---valuable nonpublic information entrusted to him in the utmost confidence.

He then exploited his ill-gotten informational advantage by purchasing securities in the market. In my view, such conduct plainly violates Section 10(b) and Rule 10b-5."[26]

Chiarella was a roadmap for the SEC and Justice Department. First, in United States v. Newman,[27] the Second Circuit Court of Appeals upheld the conviction under a misappropriation theory of employees of two investment banking firms who traded in stocks based on confidential information about upcoming tender offers. Then, in SEC v. Materia,[28] the same court affirmed civil liability based on misappropriation against a printer who had engaged in activities similar to those of Chiarella.

The news organizations argued that Dirks v. SEC[29] rather than Materia controlled the disposition of the Winans case. Raymond Dirks was a securities analyst who discovered a massive fraud at Equity Funding of America. Dirks passed his information to his clients,[30] many of whom sold their shares in Equity Funding before knowledge of the fraud became public. The SEC attempted to impose civil liability on Dirks for tipping his clients. The agency argued that Rule 10b-5 required Dirks to make his information public before relating it to his clients. The Supreme Court rejected the SEC position. The Court held that an obligation to disclose arose only if Dirks had a duty to Equity Funding or to buyers of its stock. Dirks had no such relationship.[31] For such a duty to be imposed on an outsider, the Court said, there must be a relationship in which "the corporation must expect the outsider to keep the disclosed

nonpublic information confidential, and the relationship must imply such a duty."[32]

The company in Materia had a contract to print tender offer documents. The Wall Street Journal, Winans' employer, had no such relationship. The news organizations contended Winans position was more like that of Dirks than Materia. Since there was no expectation that the information in "Heard on the Street" would be kept confidential---indeed, the purpose of a newspaper is to print---Materia could not control. The contention was rejected. The court in Winans found Dirks irrelevant. It reasoned that Winans was being tried for misappropriating property of the Wall Street Journal. He was not accused of violating a duty to the corporations whose shares he and his confederates purchased or the sellers of those shares.[33]

There also was an unsuccessful attempt to distinguish Materia on the basis that Materia's employer was a fiduciary and could be prosecuted for securities fraud if it had traded on the confidential information in its possession. By contrast the Wall Street Journal owed no duty to market participants. It could not misappropriate its own property and therefore could not be prosecuted under the government's theory if it had traded on information in "Heard on the Street" columns prior to publication.[34] The Winans court said it did "not see why it is such an anomaly that an employer and employee could not be prosecuted under the same theory."[35]

The Wall Street Journal's code of ethics and the court's finding that Winans knew of it was crucial to the Winans decision. The Justice Department had conceded that it could not have prosecuted under a misappropriation theory if the newspaper had been without the ethics code. The court said:

> "We are not entirely sure that such a concession was necessary, but we understand it to mean that, if the Wall Street Journal could not show that it had set out the rules, it could not be said that Winans had breached any duty. The contention that criminal liability cannot be premised on as broadly stated and aspirational a set of guidelines as the Dow Jones policy is just not persuasive. While the policy itself tries to cover many ethical gray areas, and it may be difficult to tell whether some conduct fits within the guidelines, this case does not present any such problems. Winans breached the policy and he knew he was breaching it."[36]

At least in relation to securities laws, the court held that a newspaper's code of ethics can have the force of law for the journalists who work for it. Even if "other newspapers do not have similar policies," the court said, "that would not change the result in this case, where we are dealing with a specific employment relationship."[37] The harm incurred by the violation of the ethics code was not financial; rather, the Wall Street Journal's "reputation for journalistic integrity was sullied."[38]

Probably because it believed the Supreme Court had spoken in Chiarella and the Second Circuit Court of Appeals had set controlling precedent in Newman and Materia, the court in Winans did not give much attention to the First Amendment contentions of the news organizations. The organizations asserted that the government's theory violated the First Amendment

protection accorded the editorial process because it would "regulate aspects of the reporter-editor relationship by imposing a vague legal obligation on a reporter to disclose breaches of the reporters' duty to his employer that may affect securities trading and an equally opaque legal duty on the editor or publishers to respond to that disclosure."[39] Apparently referring to state laws on misappropriation, the court said it was "not persuaded that the government's theory does create any new duties"[40] and added:

> "Nor does the theory impose any duties at all on publishers and editors as to what they must do if a reporter does disclose trading or tipping. Editors must make decisions about whether or not to run articles all the time, and this theory does not affect that choice at all. If Winans were to have disclosed to his editors prior to publication the fact that he was trading in the stock slated to be the subject of a 'Heard' column the following day, the editors had several choices open to them, including running the column and taking disciplinary action against Winans for his misconduct, as well as seeking criminal penalties."[41]

Challenging the government's actions against Winans places the news media in the uncomfortable position of arguing against use of securities laws to punish unconscionable acts. Winans did engage in deceptive practices in connection with the purchase and sale of securities. Nevertheless, the government's action is a "naked assertion that it has a roving commission under Rule 10b-5 to right all wrongs that may touch a securities transaction."[42] Almost all federal civil and criminal actions under securities laws start with SEC investigations. Winans can be interpreted as giving the SEC a brief to oversee the ethics of financial journalism of the responsible news media. The SEC's history of

expanding the reach of securities laws suggests that the agency will give a broad interpretation to Winans. A merely plausible complaint could result in subpoenas for reporters' financial records, the financial disclosure statements some newspapers and broadcast outlets require, and memos to editors on stories. Where there are no written ethics codes or where such codes are not rigidly enforced, Winans could generate wide ranging inquiries into ethical standards in an effort to establish the conduct a news outlet requires of its employees. The Winans court held that an ethics standard could be established by mere conversations between a journalist and his superior.[43]

While saying that the editorial process is protected from "casual inquiry,"[44] the Supreme Court has upheld wide ranging probes into the editorial process in libel suits.[45] The power of the SEC to investigate newspapers for securities law violations has received judicial approval[46] and "the fact that a demand for disclosure may have some deterrent effect on speech does not invalidate it."[47] A power of inquiry is more objectionable in a Winans-type case than in a libel suit. In a libel suit, a plaintiff must make some showing that a false statement of fact has been published. Lack of a plausible showing can defeat an inquiry into the editorial process. Since the lack of culpability in securities law deception is less obvious, it is more likely that newsroom snooping will take place.

Particularly troubling is that misappropriation liability is imposed only on employees. Despite the judge's statement in

Winans that he perceived no anomaly, there is an intuitive feeling that it is inappropriate for a federal agency to police the financial journalism ethics of reporters and not those of publishers. The philosophy underpinning federal securities laws is the desirability of honest and efficient financial markets. That philosophy is not advanced by a policy which reeks of unfairness; that is, the boss can do it but the employees cannot. This also spotlights the basic error by the Winans court in relying on Newman and Materia. The employers in those cases were under a duty not to trade on the confidential information in their possession. The Wall Street Journal had no such obligation under the theory on which Winans was convicted.

Another failing of the misappropriation theory is that it applies only to news media which have formal or informal ethics codes. Journalists at news outlets which have no code or permit employees to trade in securities based on information in upcoming stories face no liability. The theory also creates an incentive for the Newspaper Guild and those journalists with enough clout to have individual contracts to negotiate exemptions from any ethics codes and any requirements for filing financial disclosure statements with management. Potential liability under libel law already is curtailing such sound newsroom practices as reporters keeping notes or sending written memos to editors. If permitted to stand, the Winans decision can only accelerate the erosion of good editorial practices due to potential legal liability.

A three-judge panel of the Second Circuit Court of Appeals, using the same reasoning as the district court, upheld by a 2-to-1 vote the convictions of Winans, Carpenter and their confederates.[48] In particular, the court rejected the contention of news organizations that First Amendment values were at stake. It asserted that the First Amendment confers no special privileges on journalists and to accept the media's arguments would grant securities law privileges not available to nonjournalists.[49]

In a persuasive dissent, Judge Roger Miner said the majority misinterpreted the law. He maintained that securities laws only penalize misuse of securities-related information.[50] To term the publication schedule of Wall Street Journal securities-related information extends the reach of securities laws "beyond all reeasonable bounds."[51] The sweep of securities laws is broad, the judge said, but they never were intended "to protect the reputation or enforce the ethical standards of a financial newspaper."[52]

While it is difficult to oppose prosecution of journalists such as Winans, the judgment of a Chicago Tribune editorial is persuasive.

"The Securities and Exchange Commission...has the mission of protecting the financial markets from fraud and manipulation. Lately, it has been pushing at the outer limits of this role and beyond, into the danger zone of public expression of opinion.

"Reprehensible as it is for a reporter to cheat his publication and its readers through this kind of scheme, it is a matter that should be handled without the government's aid. The news organization that has been misused must take steps to rid itself of the wrongdoer and take steps to make sure it doesn't

happen again. If it fails to do so, it will suffer the loss of its readers' confidence, which is everything."[53]

Simply stated, it is not the job of the SEC to police newsroom codes of ethics.

DISCLOSURE TO READERS

The SEC believes that journalists have an obligation under federal securities laws to disclose to readers if they are trading in the securities about which they are writing. In seeking its indictment of Winans, the Justice Department asserted that he:

> "...violated his duties to the readers of the Wall Street Journal, including a duty to disclose that Winans and his co-conspirators had traded in securities knowing that the Wall Street Journal would publish articles written by Winans or others concerning those securities; that Winans and his co-conspirators traded in such securities expecting that such columns or articles would affect the price and with intent to profit from the change in price; and that Winans and his co-conspirators intended to and did trade in such securities by selling their stock or options or covering short sales immediately after such columns or other articles appeared, with the intent to profit from the change in price."[54]

Prior to trial the government dropped the nondisclosure to readers theory of fraud. The theory remained a part of the SEC's civil suit against Winans, which was settled by a consent decree. Probably the Justice Department dropped the theory because it appears to have been rejected by the Supreme Court in Chiarella and Dirks. Nevertheless, the SEC still asserts that the law imposes on journalists a duty to disclose to readers.[55]

The practice of purchasing securities in advance of stories appearing about them and then profiting from the change in prices caused by the information in the articles is known as scalping. One of the first SEC investigations of scalping involved Joe Purtell, business editor of Time. No formal charges were filed, but the SEC claimed the writer made substantial profits between 1957 and 1961 by purchasing stock in 27 companies prior to favorable articles appearing about them. Purtell left Time.[56]

In 1963, in a decision involving the Investment Advisers Act[57] rather than Section 10b, the Supreme Court ruled that a court could order publishers of a financial newsletter to disclose their securities trading to readers.[58] On six occasions the publishers of a newsletter named Capital Gains Report bought shares in companies prior to printing favorable stories on the companies. It was not alleged that the reports contained false information. The Court held that it was important to readers whether the publishers were disinterested and that failure to disclose material information worked a fraud on readers.[59] The Court said failure "to disclose material facts must be deemed fraud or deceit" and "darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive."[60]

Since Capital Gains Research Bureau, the Supreme Court has decided most financial newsletters were not intended to be covered by the Investment Advisers Act.[61] As a result the decision is no longer law. However, in SEC v. Blauvin,[62]

liability was found under Section 10b and Rule 10b-5 for failure to disclose securities trading to readers when the information in a newsletter was false. The finding of liability for scalping against Blauvin has been favorably mentioned by the Supreme Court.[63] This suggests the reasoning of Capital Gains Research Bureau, in a Section 10b and Rule 10b-5 setting, is not dead.

The SEC primarily bases its contention that journalists have a duty to disclose to readers their trading in securities about which they are writing on Zweig v. Hearst Corp.,[64] a decision by the Ninth Circuit Court of Appeals. Zweig involved Alex Campbell, a financial columnist for the Los Angeles Herald-Examiner, whose actions were as reprehensible as those of Winans. In 1969 Campbell had worked for the Herald-Examiner for about 30 years, first as a business reporter and later as financial columnist. His columns often were about small southern California companies. In the two-year period prior to mid-1969, Campbell purchased stock in 21 companies shortly before publication of columns about them. Campbell also had a financial interest in the California Financial Journal, a weekly business newspaper. It was the practice of the Financial Journal to call companies about which Campbell had written and solicit advertisements featuring reprints of Campbell's columns.

In mid-1969 Campbell wrote and the Herald-Examiner published a column about American Systems, Inc. (ASI). The column was based on interviews with ASI officers. There were allegations that some of the information given to Campbell was incorrect, but

there was no evidence that Campbell had reason to doubt the accuracy of what he wrote. Two days before the column appeared, Campbell purchased 5,000 shares of ASI from the company at a price below market. The price of ASI stock rose after the column appeared. Campbell recovered his investment by selling 2,000 ASI shares. He kept the remaining 3,000 shares as profit. The California Financial Journal solicited and ASI purchased an advertisement featuring a reprint of the Campbell column.

ASI had entered into a merger agreement with Reading Guidance Center, Inc. The agreement stipulated that ASI was to be valued based on the market price of its shares for the five days preceding June 10, 1969. Campbell's column appeared on June 4. It is unclear whether Campbell knew of the merger agreement, but there is an inference he agreed to have the column appear on or before June 4. The increase in the price enriched ASI shareholders by about $250,000 as a result of the increased valuation under the merger. Further, and more significantly, the original merger agreement contemplated that Reading Guidance owners would hold a majority of the shares in the company resulting from the merger. The price increase attributed to Campbell's column caused them to hold less than 50 percent of the shares in the new company.

An SEC action against Campbell was settled by a consent decree. Shareholders of Reading Guidance filed a private suit which alleged that Campbell and the Hearst Corporation, owner of the Herald-Examiner, had violated Section 10b and Rule 10b-5.

The action against Hearst Corporation was dismissed. In the absence of knowledge that Campbell was engaged in scalping, a court ruled the newspaper did not violate securities laws in relying on the integrity of a 30-year employee.[65] After it received complaints about Campbell's scalping, the Herald-Examiner suspended his column. Later, the column was reinstated after Campbell agreed not to write about companies in which he had a financial interest and to write only about corporations listed on the two major stock exchanges.[66] A federal district court dismissed the suit of the Reading Guidance shareholders against Campbell, asserting there was "no harm or impropriety in a columnist's 'making a nickel' at the same time he tells his readers of what may truly appear to him to be an enterprise with a bright future."[67]

The Court of Appeals reversed. Holding that Campbell was an "informal financial adviser"[68] who assumed "duties when, with knowledge of the stock's market and an intent to gain personally, he encouraged purchases of securities in the market,"[69] the court concluded:

> "While Rule 10-b 5 should not be extended to require every financial columnist or reporter to disclose his or her portfolio to all of his or her readers, it does cover the activities of one who uses a column as part of a scheme to manipulate the market and deceive the investing public."[70]

In deciding Campbell had a duty to disclose, the court applied what it termed a flexible analysis[71] and reached its conclusion as a result of four factors. First, Campbell controlled the information that he owned and intended to sell ASI

stock on a rising market and "kept those facts secret."[72] Second, his column was not an objective article. It expressed an opinion on the worth of ASI.[73] Third, as a "salaried columnist for a large newspaper, he benefited from his relationship with his readers, on whom his employment ultimately depended."[74] Finally, in addition to any journalistic purpose, Campbell had a nonjournalistic aim in writing the ASI column.[75] The court conceded that under common law Campbell had no fiduciary duty to readers, but it ruled that Rule 10b-5 creates duties not recognized at common law.[76]

One obstacle the court had in finding Campbell liable to Reading Guidance shareholders was that they had not relied on Campbell's column. The merger agreement was signed four months before the column was published. The shareholders were injured because other readers had relied on the column and bid up ASI stock. The court resolved the dilemma by holding that Reading Guidance shareholders and readers who bought ASI shares "had strikingly similar stakes in the processes of the market."[77] Both the Reading Guidance shareholders and ASI stock buyers were relying on "an honest market."[78]

The decision in Zweig is premised on a view that the law should assure fairness and equality of information among market participants. The court felt that a journalist who trades in the securities he writes about in advance of publication injects unfairness and inequality of information into the market. The information need not be confidential data on a company. Indeed,

in Campbell's case, it was his "lack of objectivity" and the absence of the "motivations of a financial columnist."[79] The SEC believes Zweig correctly sets forth federal securities law on nondisclosure by financial journalists.[80] The difficulty with the belief is that the Supreme Court apparently does not agree. Probably that was the reason the Justice Department dropped the nondisclosure to readers theory in its prosecution of Winans.

In Chiarella the Court rejected a "general duty between all participants in market transactions to forgo actions based on material nonpublic information."[81] Further, the Court said "there can be no fraud absent a duty to speak. We hold that a duty to disclose under Section 10(b) does not arise from mere possession of nonpublic market information."[82] If the Court found no duty to market participants for an employee of a printing company which had pledged confidentiality in preparing documents on takeover offers, it is unlikely that one exists for a financial journalist who works for a news outlet. The existence of a newspaper or broadcaster depends on reporting the news rather than keeping it confidential.

The Court said in Dirks that "equal information among all traders" is not required.[83] Further, the Court continued, securities analysts help maintain healthy markets by discovering and disclosing information and it "is the nature of this type of information" that it cannot be made available simultaneously to all members of the public.[84] Only when the information is

improperly disclosed to an analyst does an obligation to speak arise.[85]

Nevertheless, the SEC holds to Zweig. One reason is that the Supreme Court has never ruled on a case where the principals were a financial journalist and a general circulation newspaper or broadcast outlet. Moreover, at least as to scalping, there is dicta in Court decisions which could support a nondisclosure to readers theory of liability. In Lowe, it was noted that the SEC had been successful in using Rule 10b-5 to punish a newsletter publisher for scalping.[86] In Dirks, the Court said whether there is a duty could depend on the purpose of the principal. It indicated liability possibly could attach to a securities analyst if his actions were taken for personal gain.[87] However, such dicta do not overcome the clear conclusion that Zweig cannot pass muster under recent Supreme Court decisions. This conclusion is reached within the parameters of securities law and without regard to the theory's infringement on the First Amendment. Such infringement further tilts the scales against any duty of disclosure to readers.

CONCLUSIONS

The SEC's actions are not the first efforts by government to apply sanctions against news outlets for what is printed or broadcast,[88] but the agency's legal basis is unique. As a result, the Winans case and other SEC actions must be

considered within the confines of financial journalism. Section 10b and Rule 10b-5 apply only to fraud in connection with the purchase or sale of securities. So generalizations of SEC activities to other areas of journalism are not warranted. This does not make the editorial intrusion any less serious. The SEC is engaging in an effort to control the dissemination of all information which significantly affects trading in securities. In doing so, it is seeking to police relationships between reporters and editors and the decisions of editors on what to print. One need not have a vivid imagination to foresee efforts to apply securities laws to journalists writing about defense contracts or nuclear power plant accidents if the judiciary accepts the SEC's theories.

Judicial rejection of the SEC's misappropriation theory need not mean journalists such as Winans would go unpunished. What he stole was the "timing and tenor"[89] of Wall Street Journal articles. That is news piracy. The Supreme Court has held that news organizations have property rights in the timeliness of the news they gather.[90] News organizations could bring civil actions to enjoin news piracy and to collect money damages from news pirates and their confederates. Criminal theft charges could be filed. Relying on the illegality of news piracy and news media enforcement actions against news pirates as a deterrent to Winans-type misconduct would avoid the chilling effect of intrusion by a governmental agency into the editorial process. As such the reliance would be consistent with the First Amendment.

There is no precedent for using news piracy doctrine to deter leaking of financial news prior to publication to market traders. Thus, a news piracy action would break new ground, but this would be no more difficult than the SEC using a newly crafted misappropriation theory.

One of the difficulties in analyzing the SEC's efforts to police financial journalism is that the Supreme Court has not established the boundaries of the agency's authority under the First Amendment. The news media has learned to live with discovery in libel suits despite its effect on sound newsroom practices. That the press could accommodate an SEC brief to probe misappropriation does not make it less offensive. There is evidence that the Court may limit application of misappropriation theory to situations where the employer has a duty not to trade under federal securities laws. Fair markets is one objective of securities laws. That objective is not accomplished by a legal theory which sanctions reporters but leaves their publishers free to trade. Although the Court recognized misappropriation as securities fraud in Chiarella, it has been restrained in recognizing duties. The duties of a newspaper are not those of a company which contracts to print confidential financial documents. Further, the Court is likely to be aware of the anomaly that misappropriation applies only to news media with formal or informal ethics codes. Those who work at media which have not adopted ethical standards for employees face no liability.

In Lowe,[91] rather than offend the First Amendment, the Supreme Court held that Congress did not intend to permit the SEC to set up a licensing scheme for financial newsletters. To adopt the view that the timing and tenor of newspaper articles is not information within the reach of securities laws would be consistent with Lowe. Policing of newsroom ethics by news piracy sanctions does not disturb First Amendment values. SEC intrusion into the newsroom creates First Amendment perils. A holding that a newspaper's publication schedule is not securities-related information would be a prudent exercise of judicial restraint

While the misappropriation theory is offensive, it is the prospect of a Zweig-type duty for journalists to disclose to readers financial interests in companies about which they write that is more threatening. As one commentator has said:

"If a duty of disclosure is recognized, it will lead to endless litigation over to whom and to which stories it applies...

"While most financial columnists do not possess the market influence that Winans did, it is not uncommon for investigative and other stories to influence the performance of securities in national and local markets. If reporters must disclose their related securities holdings before writing articles which might have market influence to protect themselves from the SEC, the American press will become riddled with information on journalists' investment portfolios.

"But that is only part of the problem. If the author of an article has a duty of disclosure to his readers, then it follows so must his publisher and assignment editor. Doubtlessly, litigation would then ensue over whether rewrite persons, other editors, and production staff involved in a story would also be compelled to disclose their related securities holdings. A 30-inch story could end up with five or 10 inches of securities disclosures..."[92]

Ultimately, the Supreme Court must decide whether the First Amendment bars the imposition of security law liability upon the editorial process. The Court has held that "the First Amendment does not invalidate every incidental burdening of the press that may result from the enforcement of civil or criminal statutes of general applicability."[93] At the same time it has ruled that where First Amendment rights are infringed, the government may not use unnecessarily broad means to achieve legitimate goals.[94] And the Court has said:

> "The choice of material to go into a newspaper, and the decisions made as to limitations on size and content of the paper, and treatment of public issues and public officials---whether fair or unfair---constitute the exercise of editorial control and judgment. It has yet to be demonstrated how government regulation of this crucial process can be exercised consistent with First Amendment guarantees of a free press as they have evolved to this time."[95]

The theories of Winans and Zweig can be upheld only if the Supreme Court is willing to permit greater intrusion by government into the editorial process than it has in the past. The Court must balance First Amendment values against the government's legitimate interest in assuring honest financial markets. To allow government agencies to put courts into the business of policing journalistic ethics is outside the First Amendment tradition. There are risks to self-policing, but "the authors of the Bill of Rights accepted the reality that these risks were evils for which there was no acceptable remedy other than...a sense of responsibility."[96]

Footnotes

1. The SEC was created by the Securities Act of 1933, 15 U.S.C. 77a.

2. SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) at 186.

3. Olmstead v. United States, 277 U.S. 438 (1927) at 479 (Brandeis, dissenting).

4. U.S. v. Winans, 612 F.Supp. 827 (S.D.N.Y. 1985) ("Winans").

5. Indictment, United States v. R. Foster Winans, David Carpenter and Kenneth P. Felis. A copy of the indictment was supplied by the SEC Office of Public Affairs. Also, 17 BNA S.R.L.R. 1133-1134 (June 28, 1985).

6. 17 BNA S.R.L.R. 1445-1446 (August 9, 1985).

7. United States of America v. Winans, 1986 CCH Securities Law Rptr. 93608 (2d Cir. May 27, 1986) ("Winans II").

8. SEC v. Brant, et al, Final Judgment of Permanent Injunction and Other Equitable Relief as to R. Foster Winans, Jr., Oct. 22, 1985. A copy of the decree was supplied by the SEC Office of Public Affairs.

9. Winans, supra, at 850. Winans and Carpenter had a homosexual relationship. In its account of Winans' activities, the Wall Street Journal reported the relationship. The newspaper was criticized for the report. The court's decision vindicated the Wall Street Journal's judgment that the homosexual relationship was important in explaining details of the fraud. The court accepted Carpenter "spousal defense" and found him to be an abettor of the fraud rather than an active participant. The court said:

"We are loathe to dwell on Carpenter's 'spousal relationship' defense, since it carries with it assumptions about spousal roles which would only be true for the most subservient spouse...Carpenter was never given a share of the profits distinct from Winans' share. He was treated as Winans' uninvolved spouse, consistent with the nature of their relationship; he did not act as a conspirator, nor was he perceived as such..." Id at 849.

10. Curtis Publishing Co. v. Butts, 388 U.S. 130 (1966) at 150 (Harlan, concurring).

11. Lowe v. SEC, 105 S.Ct. 2557 (1985) (White, concurring) at 2586.

12. Reliance Insurance Co. v. Barron's, 428 F.Supp. 200 (S.D.N.Y. 1977) at 205.

13. The news organizations were the Reporters Committee for Freedom of the Press, National Association of Broadcasters, The Newsletter Association, New York Financial Writers Association, Media Institute, Newspaper Guild, Radio-Television News Directors Association, American Society of Magazine Editors, National Newspaper Association and Associated Press Managing Editors. The Wall Street Journal remained neutral on the proceedings against Winans. The organizations filed an amici brief dated Jan. 21, 1985 (hereafter "Press Brief") and a supplemental memorandum dated April 22, 1985 (hereafter "Supplemental Brief"). Copies of the Press Brief and Supplemental Brief were supplied by the Reporters Committee.

14. Supplemental Brief at 13.

15. 15 U.S.C. 78j(b). Section 10(b) states:

"It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national sdecurities exchange...

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

16. 17 C.F.R. 240.10b-5. Rule 10b-5 says:

"It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or omit to state a fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of a security."

17. Cady, Roberts & Co., 40 S.E.C. 907 (1961); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. den., 404 U.S. 1005 (1971).

18. Indictment, supra, at 8.

19. Winans, supra, at 829.

20. Indictment, supra, at 8.

21. Id.

22. Winans, supra, at 830.

23. Id.

24. 445 U.S. 222.

25. Id at 237.

26. Id at 245 (Burger, C.J., dissenting). Burger felt the trial judge's jury charge was sufficient to encompass misappropriation.

27. 664 F.2d 12 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir.), cert. den., 464 U.S. 863 (1983).

28. 745 F.2d 197 (2d Cir. 1984), cert. den., 105 S.Ct. 2112 (1985).

29. 463 U.S. 646 (1983).

30. Id at 649. There is some evidence Dirks passed the information to the Wall Street Journal, but the newspaper printed a story only after the SEC began an investigation. Id at 649-650.

31. Id at 665.

32. Id at 655, n. 14.

33. Winans, supra, at 841.

34. Press Brief at 32-33.

35. Winans, supra, at 840, n. 6.

36. Id at 842.

37. Id at 843.

38. Id at 845.

39. Press Brief at 14. The brief at 17-19 posited three hypothetical situations which could create difficulties for journalists.

The Reporter's Widowed Mother - A reporter is doing a story on General Motors and learns from a source outside the company about a problem the company may have in six months. He does not plan to prepare his exclusive story for publication for a number of weeks, but wants his widowed mother, whose total incomes is derived from GM stock, to diversify. What should the reporter do in these circumstances? Moreover, what is his editor supposed to do if the reporter does disclose that he is thinking about telling his mother to diversify? And what should the editor do if the reporter says that his mother has sold some GM stock on the basis of his information---suppress a story, even though it is a matter of public importance?

The Reporter's Inadvertent Tip - A reporter has innocently divulged information about an upcoming article to someone who occasionally serves as a source for stories. The tippee has traded on that information. Under the government's theory, the reporter has a duty to disclose this fact to his employer. But what is the employer's duty? Apparently, there is no duty to disclose to the employer's readers or anyone who might purchase or sell the securities. Nevertheless, the reporter's putative securities law violation places the editor and publisher in the uneasy position of having to decide whether or not to kill a story, which is completely accurate and presumably a matter of public importance, in order to minimize the effects of at best a colorable violation of federal law.

The Latin American Tip - A reporter discloses his intention to print an article about a possible political coup in a Latin American country and the "tippee" has sold his securities in a company that has substantial holdings there. Under the government's theory, the reporter could be liable if he knew about the securities and informed the tippee as a professional favor or perhaps for some other personal reason without first disclosing his intent to tip to his news organization. Accordingly, disclosure to the editor will impose tremendous uncertainty on the editor about whether to publish an article that is clearly of public importance.

In the Supplemental Brief at 13, the following hypothetical is posited:

A reporter obtains exclusive information about X corporation making a big oil find which he plans to use in an article for his paper. The reporter needs, however, to confirm the story before his editor will approve it. He contacts an expert geologist, who

has not heard about the oil find, but knows how to obtain some confirmation. The geologist first arranges to buy X's stock. Then the expert obtains partial confirmation through non-confidential sources. He calls back the reporter, reports his findings, reveals that he has purchased X's securities, thanks the reporter and tells him he looks forward to his article and the profits it will bring him. Under the government's theory, the reporter may be liable under the securities laws because he has used the newspaper's information and that information "touches" a securities transaction.

40. Winans, supra, at 843, n. 10.

41. Id.

42. Supplemental Brief at 8.

43. Winans, supra, at 842.

44. Herbert v. Lando, 441 U.S. 153 (1979) at 174.

45. Herbert v. Lando, supra. See Zurcher v. The Stanford Daily, 436 U.S. 547 (1978) (upholding constitutionality of search of newspaper office for evidence of a crime).

46. Securities and Exchange Commission v. Wall Street Transcript Corp., 422 F.2d 1371 (2d Cir.), cert. den., 398 U.S. 958 (1970).

47. Id at 1380.

48. Winans II, supra.

49. Id at 93615.

50. Id at 93617.

51. Id.

52. Id.

53. Chicago Tribune, Section C, page 2, June 30, 1985.

54. Indictment, supra, at 8.

55. Statements of SEC members Aulana L. Peters and Charles C. Cox, 16 BNA S.R.L.R. 1989 (Dec. 21, 1984), and John M. Fedders, chief of the SEC Enforcement Division, 16 BNA S.R.L.R. 1789-1790 (Nov. 16, 1984). See also Fedders speech reported in 1984 CCH Fed. Securities L. Rpts. 83701.

The SEC may pursue three other avenues in the future to impose liability on journalists who trade based on nonpublic information.

Where a tender offer is involved, it may invoke Rule 14e-3 under Section 14 of the Securities Act of 1934. See "SEC Insider Trading Case Could Clog Pipeline Between Bankers, Arbitragers," Wall Street Journal, Midwest Edition, p. 3, May 19, 1986.

One commentator claims the Insider Trading Sanctions Act of 1985, Pub. L. 98-376, broadens securities law to include journalists who trade in the securities they write about. Note, Financial Reporters, The Securities Laws And The First Amendment: Where To Draw The Line, 53 Fordham L. Rev. 1035 (April, 1985). He is wrong. While the record includes analyses prepared by the SEC which would possibly include journalists, Congress left intact the judiciary's discretion to define an insider. Inclusion of SEC analyses as background is not determinative of congressional intent.

The SEC has asked Congress to amend the Investment Advisers Act to include bona fide newspapers and broadcasters. The proposed amendments do not include registration of publications which offer impersonal advice, struck down in Lowe, supra, but would bring journalists under the mantle of other parts of the act. See "SEC Votes Changes In Its Regulation of Adviser Firms," Wall Street Journal, Midwest Edition, p. 14, May 28, 1986. The SEC believes the act requires disclosure in scalping-like situations.

56. Shapiro, Harvey D., Unfair Shares: Writers Who Profit from Wall Street's Pipeline, 6 Washington Journalism Review 6-35 (July/August, 1984) at 36.

57. 15 U.S.C. 80b-1.

58. Capital Gains Research Bureau, supra, at 195-197.

59. Id at 200-201.

60. Id at 200.

61. Lowe, supra.

62. 760 F.2d 706 (2d Cir. 1985).

See United States v. Amick, 439 F.2d 823 (7th Cir.), cert. den., 403 U.S. 918 (1971) (fraud conviction upheld of editor of investment publication who did not disclose promise of payment for misleading article). The publication was the Indiana Investor and Business News. It is unclear from the record whether the publication was a business newspaper, a newsletter, or mere tipster sheet. The court cited a House Committee on

Interstate and Foreign Commerce report which said the Securities Act of 1933 was designed "to meet the evils of the 'tipster sheet' as well as articles in newspapers or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for." Id at 365.

63. Lowe, supra, at 2573, n. 56.

64. 594 F.2d 1261 (9th Cir. 1979).

The Campbell case has generated substantial law review commentary. See Peskind, Regulation of the Financial Press: A New Dimension to Section 10(b) and Rule 10b-5, 14 St. Louis U. L.J. 80 (1969); Comment, Testing the Vicarious Liability of a Newspaper Publisher Under 10b-5---Zweig v. Hearst Corp., 1975 Utah L. Rev. 740; Note, The Ninth Circuit Expands the 10b-5 Net to Catch a Columnist: Zweig v. Hearst Corp., 29 DePaul L. Rev. 287 (1979); Note, A Financial Columnist's Duty to the Market Under Rule 10b-5: Civil Damages for Trading on a misleading Investment Recommendation, 26 Wayne L. Rev. 1021 (1980); Note, The First Amendment and "Scalping" by a Financial Columnist: May a Newspaper Article Be Commercial Speech?, 57 Indiana L. Rev. 131 (Winter, 1982).

65. Zweig v. Hearst Corp., 521 F.2d 1129 (9th Cir.), cert. den., 423 U.S. 1025 (1975).

66. Id at 1133.

67. Zweig (1979), supra, at 1271.

68. Id at 1269.

69. Id at 1268.

70. Id at 1271.

71. Id at 1268.

72. Id at 1269.

73. Id at 1266.

74. Id at 1269.

75. Id. Nonjournalistic motive of personal gain implied in much of opinion and stated explicitly at 1266 and 1268.

76. Id at 1269.

77. Id.

78. Id.

79. Id at 1266.

80. Id.

81. Chiarella, supra, at 233.

82. Id at 235.

83. Dirks, supra, at 657.

84. Id at 658.

85. Id at 660.

86. Lowe, supra, at 4713, n. 56.

87. Dirks, supra, at 662.

88. Mills v. Alabama, 384 U.S. 214 (1966) (overturning state law barring publication of editorial endorsement on election day); Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241 (1974) (overturning state law mandating right of reply to editorials); Landmark Communications, Inc. v. Virginia, 435 U.S. 829 (1978) (overturning state law barring publication of information on judicial disciplinary actions); Smith v. Daily Mail Publishing Co., 443 U.S. 97 (1979) (overturning state law barring publication of names of juvenile offenders).

89. Winans, supra, at 840.

90. International News Service v. Associated Press, 248 U.S. 215 (1918); Wainwright Securities, Inc. v. Wall Street Transcript Corp., 558 F.2d 91 (2d Cir. 1977); Chicago Record-Herald v. Tribune Association, 275 F. 797 (7th Cir. 1921); Pottstown Daily News Publishing Co. v. Pottstown Broadcasting Co., 192 A.2d 657 (Pa. 1963). See Sullivan, News Piracy: Unfair Competition and the Misappropriation Doctrine, 56 Journalism Monographs (May, 1978).

91. supra.

92. Media Institute, The SEC and the First Amendment (Washington, D.C. 1984), pp. 8-9.

93. Branzburg v. Hayes, 408 U.S. 665 (1972) at 682.

94. First National Bank of Boston v. Bellotti, 435 U.S. 765 (1978) at 786. See Buckley v. Valeo, 424 U.S. 1 (1976); NAACP v. Alabama, 377 U.S. 288 (1964).

95. Tornillo, supra, at 258.

96. CBS v. Democratic National Comm., 412 U.S. 94 (1973) at 125.